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Zaire: Backsliding Into an Economic Morass [redacted]

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An Intelligence Assessment

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October 1982

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Key Judgments

Information available as of 20 October 1982 was used in this report.

Zaire's economy, after showing some growth in 1980, is once again on the decline. Debt service this year is approaching $1 billion, far beyond Kinshasa's ability to pay. Depressed by weak copper and cobalt sales, export earnings are continuing to fall and cannot support the increase in imports needed to generate growth. Moreover, promising management and anticorruption reforms in the minerals industry are being overshadowed by President Mobutu's unwillingness to slash a ballooning budget deficit and to take other tough measures needed for better financial control.

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Belgium, the former colonial power, provides a further drag on reform efforts. Broad-based reform could reduce the earnings of numerous Belgian firms, which provide a wide range of services—sometimes of questionable legality—to the Zairians. Specific charges of corruption linking high Belgian and Zairian politicians, made recently in a report released by a former IMF-sponsored official at the Bank of Zaire, have prompted an investigation in Brussels.

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As matters now stand, we believe economic output this year will be stagnant at best, and prospects for 1983 are little better. Any new foreign assistance packages, including a comprehensive debt rescheduling, probably will have to await a new IMF program. The domestic economy, however, is so far out of control and Zaire's financial needs are so large that the Fund may have to relax its rigorous stipulations if Kinshasa and the IMF are to stand any chance of reaching an accord in early 1983. The Fund's reluctance to offer some guidance now is merely compounding the problem. Unless the IMF sets clear performance targets linked to a tangible program, Mobutu is unlikely to try to put the country's economic house in order any time soon.

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The absence of an agreement with the Fund would discourage prospective donors and prevent further debt relief. Zaire's economic fate would then be tied even more closely to a world minerals market that we believe will be only marginally stronger next year than in 1982. Only a strong resurgence in the minerals market would provide enough foreign exchange for Zaire to meet minimum debt servicing requirements and to achieve a semblance of recovery.

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The resumed economic decline and dim prospects are causing more widespread concern and dissatisfaction with Mobutu in Zaire. We do not believe, however, that the failing economy will set off widespread public

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disorder or spur the major insurgent group, which suffers from internal strife and lack of equipment, to significantly increase its activity.

In these circumstances, US-Zairian relations probably will be repeatedly strained. Mobutu's continuing domestic problems and his mistaken belief that the United States could easily persuade the IMF and other donors to increase aid without his having to institute and stick with needed reforms are likely to increase his frustration with what he will perceive as flagging US support. Alternating between threats and cajolery to prod the United States, we believe Mobutu will claim that other key traditional donors—Belgium and France—are more sympathetic to Zaire's plight.

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Contents

25X1

Figure 1

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Zaire: Backsliding Into an Economic Morass [redacted]

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Background

After growing at an impressive annual average rate of nearly 7 percent during 1968-74, the Zairian economy began a downturn that by 1979 had reduced output to just 84 percent of the 1974 peak. A sharp decline in copper prices was the immediate cause of the slide, but government mismanagement also took a heavy toll.

- An ill-timed program involving widespread nationalization of businesses discouraged outside participation in the economy.
- Heavy foreign borrowing was undertaken on relatively hard terms and for costly projects that overemphasized infrastructure.
- Prolonged neglect of agriculture diminished food production, leading to a decline in per capita food consumption.
- Pervasive corruption absorbed badly needed foreign exchange and compounded economic inefficiency. [redacted]

Even with a 50 percent cut in import volume, Zaire's weakened ability to meet its payments to foreign creditors resulted in a steady accumulation of arrears after 1974. At the same time, government revenues from export and import duties declined sharply, resulting in a series of budget deficits that peaked at 11 percent of GDP in 1976. The crises highlighted Zaire's widespread corruption and economic mismanagement, contributing to the virtual disappearance of outside private sources of finance by 1978. Zaire was able to muddle through the late 1970s only by failing to make debt payments, depleting its foreign reserves, and receiving foreign aid. [redacted]

Table 1
IMF Programs

Million US $

March 1976	Compensatory Financing Facility	65
March 1976	Standby arrangement (12 month)	47; made all drawings
May 1977	Compensatory Financing Facility	33
April 1977	Standby arrangement (12 month)	53; 6 drawn
August 1979	Standby arrangement (18 month)	152; made all drawings
June 1981	Extended Fund Facility	1,075; 206 drawn
March 1982	Compensatory Financing Facility	120

[redacted]

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Short-Lived Recovery

Kinshasa showed many signs in 1980 of being able to begin an economic turnaround even in the face of a 10-percent deterioration in its terms of trade. Led by the mining sector, Zaire registered real GDP growth of 2.5 percent, cut the inflation rate by more than half to 42 percent, and began to make modest repayments against total arrears of roughly $1.5 billion. Zaire also complied with the stringent terms of a $150 million, IMF standby arrangement worked out in 1979. This improvement was due more to the responsiveness of traditional donors and Kinshasa's willingness to abide by the financial discipline demanded by them than to any improvement in export earnings. Improved coordination among the United States, France, Belgium, and West Germany yielded generous financial aid and technical support for Zaire's central bank, the Ministry of Finance, and the Customs Service. [redacted]

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By early 1981, Zaire had made its last draw against the IMF standby and again was operating without Fund guidance. Mobutu—in our judgment mistakenly believing that Zaire's commendable performance under the standby arrangement would ensure access to a long-term Fund program—relaxed financial discipline. With spending controls removed, the budget deficit began to increase sharply. In mid-1981 Kinshasa once again promised to slash the deficit in order to qualify for a $1.1 billion IMF Extended Fund Facility (EFF). Zairian officials failed to follow through, however, and merely juggled accounts and deferred expenditures. The result was a deficit at the end of 1981 nearly double that targeted. [redacted]

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Table 2
Zaire: Current Account

Million US $

	1979	1980	1981 [a]	1982 [b]	1983 [b]
Trade balance	728.6	752.3	420.3	331	497
Exports (f.o.b.)	1,834.6	1,953.6	1,477.3	1,409	1,589
Copper	678.9	912.1	723.0	635	750
Cobalt	570.8	377.8	161.4	140	154
Crude oil	152.7	225.2	264.2	261	261
Other	432.2	438.5	328.7	373	424
Imports (f.o.b.)	1,106.0	1,201.3	1,057.0	1,078	1,092
Crude oil	149.9	209.5	257.0	257	267
Other	956.1	991.8	800.0	821	825
Net services [c]	−780.4	−884.7	−780.0	−700	−859
Unrequited transfers	67.2	134.1	104.4	86	83
Current account balance	**15.4**	**1.7**	**−255.3**	**−283**	**−279**

[a] Estimated.
[b] Projected on the basis of no growth in real GDP.
[c] Figures for 1979-80 include interest due before rescheduling. Estimates for subsequent years include interest payments Zaire is expected to be able to meet.

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[redacted]

Zaire's international payments picture mirrored the problems in the domestic economy. A softening world market for copper and cobalt, which account for 60 percent of total exports, depressed foreign sales in 1981 to just 75 percent of the 1980 level. Despite a 12-percent drop in imports, the current account deteriorated from a small surplus in 1980 to a $255 million deficit. Reductions in imports of raw materials and equipment for the manufacturing and mining sectors contributed to a 2-percent drop in real GDP in 1981. [redacted]

The failure of the IMF and key bilateral donors to closely monitor and coordinate their aid programs to meet Zaire's growing foreign exchange needs compounded the country's economic troubles. The EFF program collapsed by the end of 1981, as Zaire missed the Fund's performance targets—aimed largely at capping the budget deficit, domestic credit, and the foreign payments backlog—by wide margins. Despite the disbursement of over $200 million in IMF funds, Zaire had fallen too far behind on debt payments to catch up. Even though the Paris Club, a group of Western governmental creditors, had reduced debt service for 1981 from $790 to $370 million, Zaire paid only $240 million. Kinshasa still had to draw down its foreign exchange reserves to less than $125 million, equivalent to the amount needed to cover six weeks' imports. [redacted] 25X1

Roadblocks to Recovery

Although Zaire's economic fortunes hang on a shaky world minerals market, there are numerous other factors that inhibit a quick recovery. While some problems are clearly of Zaire's making, there are others about which Kinshasa can do little. [redacted] 25X1

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Corruption. Zaire's underground economy of payoffs needed to complete even the simplest business transactions and its well-developed black market match those of many African countries. Zairian corruption may be more visible, however, because of the relatively rich pickings in the minerals industry, the international financial community's heavy involvement in

Table 3
Debt Rescheduling Agreements

		Million US $
June 1976	Paris Club [a]	211
November 1977	Paris Club	200
December 1979	Paris Club	1,200
April 1980	London Club [b]	402
July 1981	Paris Club	523

[a] Official creditors.
[b] Private creditors.

attempts to bail out Zaire's economy, and widely publicized charges that Mobutu is the major beneficiary of Zairian corruption.

When minerals earnings are high, Zaire can prosper despite large-scale corruption; in lean times, however, the economy sinks under the weight of graft and outright theft, In addition to mineral thefts, the US Embassy estimates that $250 million of exports were smuggled out last year. The earnings from illegal exports generally return to Zaire in the form of cash or imported goods, but taxes and customs duties are lost to Kinshasa. Kickbacks to officials who arrange transport charges on imports at exorbitant rates hit the average consumer as well as the government, which subsidizes many urban consumer items. The total impact of corruption on foreign exchange earnings, government revenues, and consumer prices cannot be precisely measured, but the magnitude of theft and smuggling suggests that Zaire could generate economic growth and improve living conditions even during the current world recession if corruption were eliminated.

Difficulty of Reform. Attempts to improve management or eliminate corruption will continue to collide with the system Mobutu uses to govern Zaire. Access to the spoils of corruption and protection from public exposure are major perquisites doled out by Mobutu to high government and military officers. He is willing to overlook self-enrichment by subordinates as long as they are loyal. 25X1

An almost constant rotation of individuals among positions in and out of government assures that each remains apprehensive about his job security and 25X1 mindful of his dependence on Mobutu's good will. This approach discourages hard decisionmaking and favors inefficient management centralized around Mobutu and his cronies. Even within this group, jockeying for power and Mobutu's favor often inhibits sound, rational management. The frequent selection of candidates for important jobs on the basis of 25X1 political or tribal loyalty rather than technical competence also contributes to poor administration.

The institutionalization of corruption and mismanagement leads us to believe that Zaire is unlikely to 25X1 reform substantially, although limited improvement is possible with direct and continuous international pressure. Even then, Zaire will respond to pressures for reform only when in dire need of assistance. In this regard, World Bank guidance has been instrumental in the encouraging changes that have taken place over the last 18 months. These include: 25X1

- Fairer assessment of the tax liabilities of GECAMINES, the government mining company.
- Replacement of the corrupt Zairian head of GECAMINES with an experienced Belgian. 25X1
- Assurances from the Bank of Zaire that GECAMINES will receive a larger share of its earnings in foreign exchange to support needed imports.
- A new accord between GECAMINES and SOZACOM—the state-run minerals marketing agent—that will provide a better record of transactions between these companies and thereby reduce the potential for theft.

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The Belgian Connection. The economic ties between Belgium and Zaire are legion, and, according to the US Embassy in Brussels, account for 60,000 jobs in Belgium and a Belgian population of roughly 20,000 in Zaire. Belgium also is Zaire's largest trading partner and bilateral aid donor. In 1980, for example, Belgian imports from Zaire reached $1.2 billion, its exports to Zaire totaled $260 million, and foreign aid was $145 million. [redacted]

At the hub of these relations rests Societe Generale de Belgique (SGB), which the press has touted as having controlled 70 percent of the Zairian economy during the colonial period. Widespread nationalization after independence removed ownership of mining interests from Belgian hands, but SGB skillfully assumed the role of an integrated marketing agent by providing processing of raw materials, shipment, insurance, financing, and sales. Its subsidiaries, Societe Generale des Minerais (SGM) and Metallurgie Hoboken Overpelt (MHO) handle the processing and marketing of Zairian copper and cobalt. The Zairian Government mining company, GECAMINES, in addition to having recently named a Belgian as managing director in Zaire, is headquartered in Brussels. SOZACOM, entirely staffed by Zairians, is the designated marketing agent, but most of its sales are made to or through SGM. [redacted]

Because of the lucrative and partially illegal role of Belgian firms in Zairian minerals sales, Brussels has been lukewarm to broad-based reform. [redacted]

Specific charges of corruption linking high Belgian and Zairian officials, made public in Belgium in September, have prompted a government investigation there. Erwin Blumenthal, a German banker, who served during 1978 and 1979 as the IMF-sponsored Principal Director of the Bank of Zaire, alleges the involvement of several prominent Belgian politicians in Zairian corruption. His report is as yet unsubstantiated, but may prove embarrassing to Alfred Cahen, the Political Director of the Belgian Foreign Ministry, 25X1 who is accused of being on Mobutu's payroll. Two former Prime Ministers are also implicated, most notably Edmond Leburton, who is reported as having directly received $750,000 in cash from Mobutu. [redacted]

Poor Cobalt Pricing Policies. Kinshasa must bear some blame for its export problems. Western cobalt consumers undertook extensive substitution efforts after the second rebel invasion of Shaba Region in 1978 sparked a speculative surge in cobalt prices. The interruption of Shaba production and shipments was short lived, however, and contributed only marginally to the shortages caused by speculative hoarding. In the face of falling prices and reduced demand, Kinshasa resisted cuts in its official sales price and relied on its reputation as a dependable supplier of high-quality cobalt to keep sales up. However, Zaire's cobalt exports fell by 20 percent in 1979 and 34 percent in 1980, pushing cobalt stocks up by 10 and 40 percent, respectively. Although SOZACOM lowered its price in stages from $25 in early 1981 to the current $12.50 per pound, the free market price remains well below Zaire's discount price for large purchasers. As a result, Zaire's share of US cobalt imports fell from 44 percent in 1979 to 25 percent last year. [redacted]

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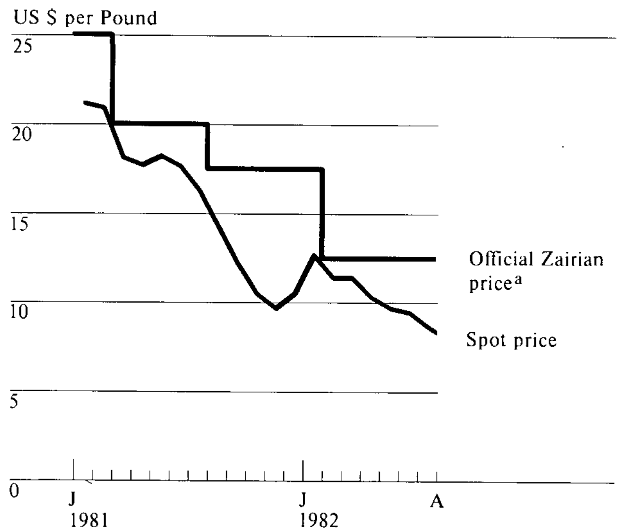
The Debt Burden. Although Zaire's $4.7 billion external debt is small compared with that of a number of non-African LDCs, Kinshasa presently cannot even cover interest charges. Since early 1982 Zaire has paid only for imported food and fuel and made some repayments to the IMF. The foreign exchange bind is 25X1 so tight that allocations for fuel have been cut from $26 million to less than $15 million monthly, and a strict petroleum rationing plan has been instituted. [redacted]

Payments due this year for debt service total nearly $1 billion and are scheduled to remain near $700 million annually past mid-decade. We project export earnings through 1983 to hold at approximately the

Figure 2
Zaire: Cobalt Prices



[a] Between August 1981 and February 1982, the cobalt price was fixed in Belgian Francs resulting in a defacto price decline because of the dollar's appreciation.

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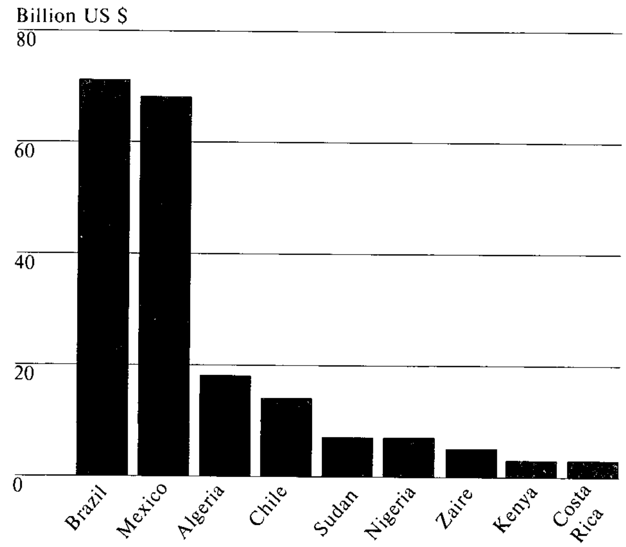
Figure 3
Selected Countries: Total Debt, End of 1981



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1981 level of $1.5 billion. The Paris Club agreement in 1981 set debt payments through the mid-1980s based, at least in part, on overoptimistic IMF projections of Zaire's mineral sales that were apparently made to demonstrate Kinshasa's potential to improve its lot over the course of the three-year EFF. When the world minerals market weakened substantially, Kinshasa was unable to meet the expectations of creditors and donors. No marked improvement in earnings is imminent, and Zaire will not be able to meet scheduled debt payments and maintain minimum import levels for essential consumer and industrial goods without substantial outside help.

Domestic Economic Policies. Uncontrolled public spending is at the root of domestic economic policy problems. The originally projected 1982 budget deficit of $180 million is expected by the US Embassy to triple by the end of the year. Reduced revenues—a result of low domestic tax collections and decreased customs receipts—and growing expenditures, particularly for such political activities as hosting the Franco-African Summit, contribute to the ballooning deficit. Financing the deficit has squeezed the availability of credit to the private sector and further slowed economic activity. 25X1

Monetary expansion to help cover the deficit has reached an annual rate of nearly 70 percent and is reversing the moderation of inflation that began in 1980. Rising inflation, in turn, will renew pressure on both the official and black-market exchange rates and probably lead to IMF demands for another round of devaluations. Zaire, unlike most of its African neighbors, has been willing to devalue at IMF request despite the economic dislocations over the short run. Since 1976 the domestic currency, the zaire, has been devalued in steps from $2.00 to $0.18 currently.

If Mobutu wants to break the pattern of chronic foreign exchange and debt problems, he will have to take additional steps such as raising domestic interest rates to generate saving and better allocating credit to

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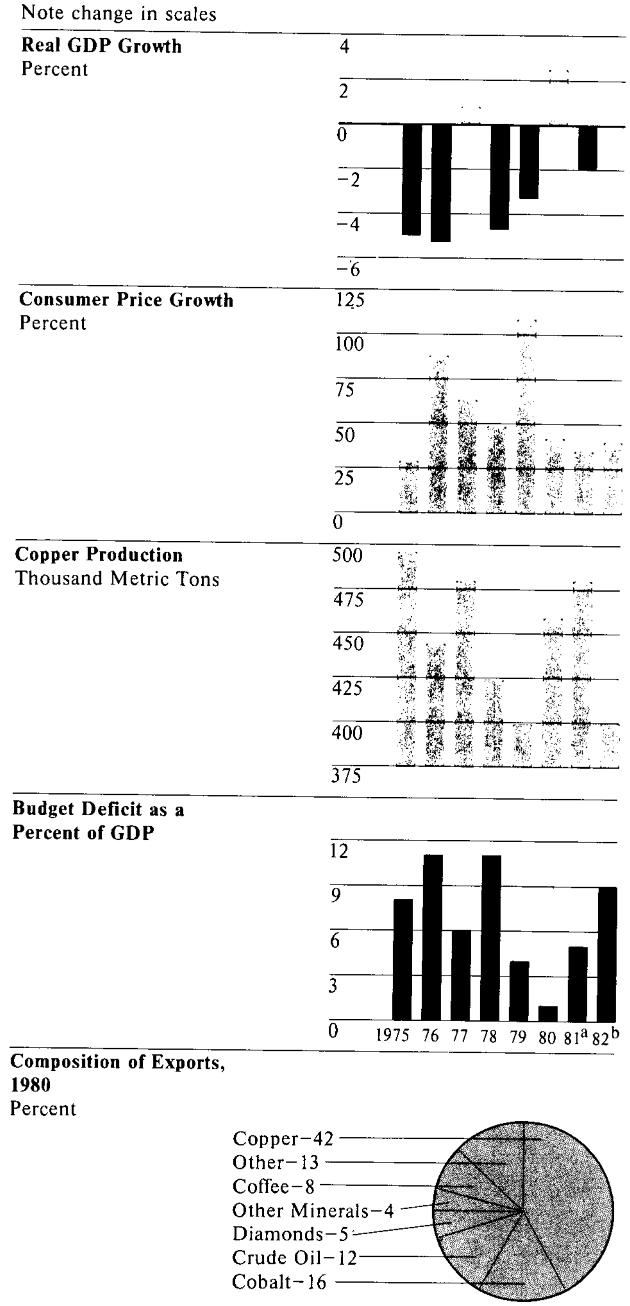
Figure 4
Zaire: Selected Economic Indicators



[a] Estimated.
[b] Projected.

587633 9-82

the most profitable projects. In addition, he needs to press ahead with price decontrol to trim the budget deficit. Given the political constraints on Mobutu, however, substantial changes in these areas cannot be expected. Mobutu is probably unwilling to risk incurring the wrath of politically important city dwellers, who would balk at losing their subsidies, and farmers, who require cheap credit. 25X1

Dismal Prospects Through 1983

These obstacles work against a quick recovery and make Zaire's economic fate over the next 15 months or so even more dependent on a world minerals market that looks only marginally stronger than in 1982. International aid will be crucial to any recovery, but no reasonable amount of aid could offset a continued soft minerals market in 1983:

- A continued weak market characterized by low copper prices and stagnant demand for cobalt probably would generate another decline in export revenues and result in a 2- to 4-percent decline in real GDP.

- A moderate recovery of copper prices, perhaps to an average of $0.85 per pound, compared with $0.63 currently, along with $500-600 million in debt relief and new assistance, could allow Zaire to stabilize its economy.

- Only in the unlikely event of a strong resurgence in the minerals market that would both push average copper prices above $1.00 per pound and boost demand for cobalt would Zaire be likely to begin a recovery. 25X1

After nearly a year of operating without Fund guidelines and credit, Zaire's domestic economic management has deteriorated so badly and its financing needs have grown so large that any accommodation with the IMF will be harder to achieve than in the past. We believe that the Fund will have to significantly dilute its standards of performance if it is to stand any chance of offering Zaire a new standby program in early 1983 with targets that Kinshasa can reasonably be expected to meet. Although substantial payments due to the Fund from previous programs could absorb much of any new credit it provides, compliance with

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an IMF program would provide Zaire the credentials that could open the door to some funds from international donors and bankers. It also would be a prerequisite for a fifth Paris Club debt rescheduling which Zaire will need if it is to generate a lasting recovery and begin to chip away at its overhanging debt.

The IMF's cautious approach to dealing with Zaire is also causing problems. The Fund has not consulted with Zairian officials on specific targets that if reached could result in a new standby agreement. Instead, the IMF has expected Kinshasa to take the initiative in drawing up a recovery plan and demonstrating sound economic performance before such consultations take place. Unsophisticated in economic matters and not a self-starter on reform, Mobutu must have clear guidelines to steer a new course. Based on his actions in 1980, we believe that he would be willing—although reluctant on matters that touch on his personal finances and with some grumbling on other reforms—to accept specific targets aimed at sound financial management.

Should Kinshasa be unable to reach an accommodation with the Fund, further debt rescheduling would not be possible. In that case, debt servicing probably would drop to near zero next year. This might cause foreign banks to call in their loans, a possibility that Mobutu might be willing to risk in the hope that it would force Western countries to acknowledge Zaire as important enough to rescue from bankruptcy. If weakness in the minerals market persists, Zaire would still be hard pressed to cover even basic food and fuel imports with projected foreign exchange inflows because pervasive corruption handicaps any reordering of import priorities. Without new outside assistance and debt relief, only a strong rebound in the minerals market and resultant higher export earnings would allow debt repayments of about $250 million and a moderate reversal of the slide in growth.

Despite Mobutu's domestic problems, we believe there is a slightly better-than-even chance that he will remain in power at least over the near term. To the extent that mineral earnings begin to recover and Mobutu reaches at least a temporary accommodation with the IMF, the better will be his chances for holding on. Although popular dissatisfaction with Mobutu is now widespread, domestic opposition is weak and unorganized. In our view, economic troubles will not significantly increase prospects of greater activity by the rebel Front for the National Liberation of the Congo, which suffers from internal strife and lack of equipment. Moreover, most Zairians have long been accustomed to severe hardship and Mobutu has adroitly prevented the emergence of any leader or organization around which the urban poor might coalesce. If serious disorders occur in one or more urban centers, the distances between cities and poor communications, among other factors, would work against their developing into serious nationwide opposition.

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US Relations

Washington's relations with Kinshasa probably will be periodically strained because of Mobutu's mistaken belief that US influence with the IMF, World Bank, and other donors can directly increase assistance without a prior demonstration of sound, effective financial management. In recent months, he has relied more than before on the hope that his political support for the United States on important international issues—and Zaire's current seat on the UN Security Council—would impel Washington to arrange for increased economic help. Mobutu's excessive expectations for aid are likely to lead to massive frustration as the United States continues to support established procedures of international financial institutions and refuses to push for special treatment for Zaire. As in the past, Mobutu is likely to alternate between threats and cajolery as he blames Washington for failing to give Zaire the support deserved by a dependable friend—support Mobutu will claim he receives from Belgium, France, and more recently, Israel. Nonetheless, we believe Mobutu will try to restrict the scope and duration of any damage to US-Zairian ties.

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